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Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue NW.
Washington, D.C. 20551

Subject: Docket No. 1438 and RIN 7100—AD—86
Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies

Dear Secretary Johnson:

On behalf of Nationwide Mutual Insurance Company and its affiliated companies ("Nationwide"), we appreciate the opportunity to provide comments to the Board of Governors of the Federal Reserve System (the "Board") on its proposed rules on the Enhanced Prudential Standards and Early Remediation Requirements (the "Proposed Rules")[1] implementing Sections 165 and 166[2] of the *Dodd-Frank Wall Street Reform and Consumer Protection Act* (the "Dodd-Frank Act"). Nationwide operates through an insurance holding company system registered with the Ohio Department of Insurance. By virtue of its ownership of Nationwide Bank, member FDIC, Nationwide is registered as a savings and loan holding company ("SLHC") pursuant to Section 10 of the *Home Owners' Loan Act of 1933* ("HOLA") and, therefore, is affected by certain aspects of the Proposed Rules.

As an initial matter, Nationwide has reviewed the Financial Stability Oversight Council's (the "Council's") final rule and interpretative guidance on the designation of nonbank financial companies to be supervised by the Board, and based on the objective criteria and designation process outlined therein, does not believe it will be designated a systemically important financial institution by the Council.[3] As a result, Nationwide does not believe it will be subject to the vast majority of the Proposed Rules, which are applicable to nonbank financial companies supervised by the Board ("NBFCs") and bank holding companies ("BHCs") with total consolidated assets equal to or greater than $50 billion ("Large BHCs," and together with NBFCs, "Covered Companies"). However, as a SLHC with approximately $155 billion in total

[1] Enhanced Prudential Standards and Early Remediation Requirements for Covered Companies. 77 Fed. Reg. 594 (Jan. 5, 2012).

[2] All Section references are to the Dodd-Frank Act unless noted otherwise.

[3] Authority to Require Supervision and Regulation of Certain Nonbank Financial Companies. 77 Fed. Reg. 21637 (April 11, 2012).

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consolidated assets as of the 2011 fiscal year-end, Nationwide would be subject to the requirement in the Proposed Rules to conduct annual company-run stress tests.[4] Notwithstanding the limited applicability of the Proposed Rules, Nationwide appreciates the opportunity to comment and respectfully offers the following suggestions and observations detailed more fully below:

- The Board should not extend the Proposed Rules to SLHCs with "substantial banking activities" as proposed;
- The Board should exclude NBFCs from the Proposed Rules and institute a separate rulemaking to address NBFCs;
- The Board should consider the degree to which a NBFC is already regulated when determining how to tailor the Proposed Rules;
- Any phase-in period for the Proposed Rules should allow a NBFC sufficient time to comply.

In addition, Nationwide respectfully requests that the Board consider its comments on the individual components of the enhanced prudential standards and early remediation requirements, which are outlined in section V of this letter.

I. The Board Should Not Extend the Requirements of Sections 165 and 166 to SLHCs with "Substantial Banking Activities."

The Board states its intention to apply the Proposed Rules, at a later date, to SLHCs with "substantial banking activities" pursuant to its authority under HOLA. An SLHC with "substantial banking activities" is defined as:

(i) having total consolidated assets of $50 billion or more; and
(ii) (A) has savings association subsidiaries which comprise 25 percent or more of such savings and loan holding company's total consolidated assets, or
(B) controls one or more savings associations with total consolidated assets of $50 billion or more.[5]

Nationwide believes that it would be inappropriate for the Board to use its authority under HOLA to apply the more stringent prudential standards to SLHCs that are neither Large BHCs nor NBFCs. The Dodd-Frank Act clearly indicates that the development of more stringent standards is to prevent or mitigate risk to the financial stability of the United States that is prospectively posed by a limited set of entities (*i.e.*, Large BHCs and NBFCs).[6] Section 165 explicitly provides

[4] Proposed 12 CFR § 252.143.

[5] 77 Fed. Reg. at 598.

[6] See 12 U.S.C. § 5365(a)(1) and 5366(a).

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that these standards are intended "to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress or failure, or ongoing activities, of large, interconnected financial institutions," and that the Board's enhanced prudential standards are to be applied to "nonbank financial companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000," and that these standards must be "more stringent than the standards and requirements applicable to nonbank financial companies and bank holding companies that do not present similar risks to the financial stability of the United States." Section 166 similarly only applies, on its face, to Covered Companies.

Indeed, Title I of the Dodd-Frank Act is a comprehensive statutory framework conceived and specifically designed by Congress to address macro-prudential risks (*i.e.,* risks to U.S. financial stability), and it is not appropriate for the Board to extend the statutorily-required enhanced prudential standards and early remediation standards to SLHCs that are non-Covered Companies based upon its micro-prudential safety and soundness authority.[7] In fact, Congress specifically chose not to define SLHCs as Covered Companies and extended only the stress testing requirement to financial companies – other than Covered Companies – with consolidated assets of more than $10 billion.[8] Moreover, Congress empowered the Council, not the Board, with the authority to designate firms as systemically significant.[9] As noted below, the tailoring of the more stringent standards by the Board, as directed in the statutory framework, should occur at the time of designation, taking into account risks identified and recommendations by the Council. Nationwide is concerned that a reliance by the Board upon its micro-prudential safety and soundness authority could be viewed as bypassing the Title I statutory process by imposing upon SLHCs requirements that Congress elected not to impose. We respectfully request that the Board not apply the Proposed Rules to entities other than to Large BHCs and NBFCs, as appropriate, and within the Title I framework.

II. The Board Should Exclude NBFCs from the Proposed Rules and Institute a Separate Rulemaking Setting forth a Process to Tailor the More Stringent Standards to NBFCs Consistent with Recommendations from the Council in the Designation Process.

Section 165(a)(1) of the Dodd-Frank Act begins with a statement of its purpose, which provides:

> to prevent or mitigate risks to the financial stability of the United States that could arise from the material financial distress, or ongoing activities, of large, interconnected financial institutions, the Board of Governors shall, on its own or pursuant to recommendations by the Council under Section 115, establish prudential standards for nonbank financial

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[7] See Preamble to Proposed Rules, 77 Fed. Reg. 595, n.7: "Micro-prudential supervision focuses on surveillance of the safety and soundness of individual companies, whereas macro-prudential supervision focuses on the surveillance of systemic risk posed by individual companies and systemic risks posed by interconnectedness among companies."

[8] See 12 U.S.C. § 5365(i).

[9] See 12 U.S.C. § 5323(a)(1).

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> companies supervised by the Board of Governors and bank holding companies with total consolidated assets equal to or greater than $50,000,000,000...[10]

Section 165(a)(2) provides that in prescribing more stringent prudential standards, the Board may, on its own or pursuant to a recommendation of the Council in accordance with Section 115:

> differentiate among companies on an individual basis or by category, taking into consideration their capital structure, riskiness, complexity, financial activities (including financial activities of their subsidiaries), size and any other risk-related factors that the Board of Governors deems appropriate.[11]

Section 165(b)(3) further provides that in prescribing prudential standards under Section 165(b)(1), the Board shall:

> (A) take into account differences among nonbank financial companies supervised by the Board of Governors and bank holding companies described in subsection (a) based on
> (i) the factors described in subsections (a) and (b) of section 113;
> (ii) whether the company owns an insured depository institution;
> (iii) nonfinancial activities and affiliations of the company; and
> (iv) any other risk-related factors that the Board of Governors determines appropriate;
>
> (B) to the extent possible, ensure that small changes in the factors listed in subsections (a) and (b) of Section 113 would not result in sharp, discontinuous changes in the prudential standards established under paragraph (1) of this subsection;
> (C) take into account any recommendations of the Council under section 115; and
> (D) adapt the required standards as appropriate in light of any predominant line of business of such company, including assets under management or other activities for which particular standards may not be appropriate.[12]

Further, Section 165(b)(4) provides the following:

> Before imposing prudential standards or any other requirements pursuant to [Section 165], including notices of deficiencies in resolution plans and more stringent requirements or divestiture orders resulting from such notices, that are likely to have a significant impact on a functionally regulated subsidiary or depository institution subsidiary of a nonbank financial company supervised by the Board of Governors or a bank holding company described in subsection (a), the Board of Governors shall consult with each Council member that primarily supervises any such subsidiary with respect to any such standard or requirement.[13]

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[10] 12 U.S.C. § 5365(a)(1).

[11] 12 U.S.C. § 5365(a)(2).

[12] 12 U.S.C. § 5365(b)(3).

[13] 12 U.S.C. § 5365(b)(4).

Thus, under Section 165(a)(1), the Board, on its own or pursuant to recommendations of the Council under Section 115, must establish enhanced prudential standards for NBFCs and Large BHCs. Under Section 165(a)(2), in prescribing the enhanced standards, the Board may, on its own or pursuant to a recommendation of the Council under Section 115, differentiate among companies on an individual basis or by category, taking into account various factors including capital structure, riskiness, complexity, financial activities, size and other risk-related factors that the Board deems appropriate. Further, Section 165(b)(3) specifically provides that in prescribing the prudential standards, the Board *shall* take into account differences among NBFCs and Large BHCs; *shall* to the extent possible, ensure that small changes to the statutory factors would not result in sharp discontinuous changes in the more stringent standards; *shall* take into account recommendations from the Council under Section 115; and *shall* adapt the standards as appropriate in light of the predominant business line of the company. And under Section 165(b)(4), before imposing more stringent requirements on a NBFC, the Board *shall* consult with each of the Council members that primarily supervises any functionally regulated subsidiary with respect to any such standard.

From the foregoing statutory language, it is clear that the Board is directed by statute to:

- take into account various risk-based factors including capital structure, riskiness, complexity and size in prescribing more stringent standards;
- take into account differences among NBFCs and Large BHCs;
- ensure to the extent possible that changes to the statutory factors would not result in sharp discontinuous changes in the more stringent standards;
- take into account Council recommendations and consult with Council members that supervise functionally regulated entities like insurance companies; and
- adapt the standards for NBFCs in light of its predominant business line where applying BHC standards may not be appropriate.

However, contrary to the statutory mandates listed above, the Preamble to the Proposed Rules states that "[t]his proposal would apply the same set of enhanced prudential standards to covered companies that are [Large BHCs] and covered companies that are [NBFCs]."[14] The Preamble goes on to state, "this proposal was largely developed with large, complex bank holding companies in mind."[15] It further states, "[f]ollowing designation of a [NBFC] by the Council, the Board would thoroughly assess the business model, capital structure, and risk profile of the designated company to determine how the proposed enhanced prudential standards and early remediation requirements should apply."[16]

The approach taken by the Proposed Rules is inconsistent with the statutory mandates of the Dodd-Frank Act, and it fails to sufficiently and effectively calibrate the risks presented by NBFCs to the more stringent standards required by the Proposed Rules. We believe that in light of these concerns, the Board should exclude NBFCs from the current rulemaking and institute a

[14] 77 Fed. Reg. at 597.

[15] 77 Fed. Reg. at 597.

[16] 77 Fed. Reg. at 597.

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separate rulemaking that would more clearly articulate the process for tailoring the more stringent standards, as appropriate in light of the risk posed, to individual NBFCs as part of the designation process, which would also take into account recommendations from the Council. For NBFCs that are predominantly insurance companies, this would provide the benefit of having insight from a State insurance commissioner, an insurance expert, and the director of the Federal Insurance Office, each of whom is a member of the Council, and satisfy the directive in Section 165(b)(4).

Notably, the mandates in the Dodd-Frank Act, set forth in Section 165(b)(3) referenced above, require the Board to take into account the differences among the "Covered Companies" based upon the factors set forth in Section 113, which governs designation of individual NBFCs. By integrating the tailoring of more stringent standards to the individual company at the time of designation, the Board would (i) obtain input from the Council, whose membership includes insurance representation; (ii) be in a position to understand the risks pertinent to the NBFC under consideration for designation; (iii) be in a position to specifically tailor and design more stringent standards for the NBFC, which will have had notice and opportunity to be heard; and (iv) allow an observation period under which it could monitor the effectiveness of the standards and engage in a dialogue with NBFC as a sensible means to adjust the standards and adapt them to the risk presented, as appropriate. Such an approach recognizes the integral and economical operation between the designation process, which identifies risks, and the design of more stringent standards, which are calibrated to the risk and serve to remediate it. Moreover, the foregoing approach would satisfy the statutory mandates set forth above. If the Board were to decide that more stringent standards should apply to a class of companies, it should institute a rulemaking for public comment outlining the standards for those classes. For NBFCs that are predominantly insurance companies, such standards should be crafted to be insurance-centric (as opposed to bank-centric) – particularly if the insurer owns a small depository institution relative to its size or does not own a depository institution at all.

Thus, Nationwide suggests a separate rulemaking with respect to NBFCs that would satisfy the statutory mandates discussed above, and that sets forth the process by which the Board would fashion more stringent standards at the time of designation. If the Board so chose, it could also set forth how the statutory considerations would be reflected in standards for classes of companies based upon their predominant line of business (*e.g.*, NBFCs that are predominantly insurance companies). We believe that a separate rulemaking as to the process for individual tailoring of the more stringent standards for a class of NBFCs based on their predominant line of business is appropriate because of the complexities involved in translating the statutory risk factors, which are considered in the designation process, into mitigating prudential standards. We believe the Board would be justified in instituting a separate rulemaking for NBFCs in light of these complexities. Notably, the Board is taking a similar approach with respect to the U.S. operations of foreign banking organizations insofar as it is instituting a separate rulemaking in recognition of the complexities unique to those entities.[17]

[17] See 77 Fed. Reg. at 595.

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III. The Board Should Consider the Degree to Which a NBFC is Already Regulated When Determining How to Apply the Sections 165 and 166 Standards.

The Board asks whether it should consider additional characteristics of a NBFC when determining how to apply the Proposed Rules.[18] As explained above, Nationwide recommends a separate rulemaking with respect to NBFCs that clearly sets forth the process by which the Board will tailor the more stringent standards to individual firms or classes of NBFCs in a manner consistent with the statutory mandates. However, whether it is contained in this separate rulemaking or in a revised version of the Proposed Rules, Nationwide strongly recommends that the Board consider the factor in Section 113(a)(2)(H), "the degree to which the company is already regulated by 1 or more primary financial regulatory agencies."[19]

As an example, a NBFC that is also an insurance company is already subject to comprehensive state-based insurance laws regarding financial solvency. Insurance companies must comply with the state risk-based capital regime, which was developed by the National Association of Insurance Commissioners ("NAIC") using formulas designed specifically for insurance companies and the business model of insurance.[20] Because the nature of an insurance company's assets, liabilities, and capital is markedly different than that of a BHC, Nationwide urges the Board, in developing minimum risk-based and leverage capital requirements, to incorporate the NAIC's risk-based capital regime when applying these more stringent standards to NBFCs that are also insurance companies, and to deem these capital requirements as equivalent to, or not quantitatively lower than, the capital requirements for insured depository institutions.

Thus, for NBFCs that are predominantly insurance companies, Nationwide believes that the Board, wherever possible, should consider whether sufficient prudential regulation already exists in the state insurance regulatory scheme. In addition, the Board should recognize the Council's authority under Sections 112 and 120 of the Dodd-Frank Act to make informal and formal recommendations to the state departments of insurance to apply new or heightened standards to NBFCs that are predominantly insurance companies and, in light of this authority, consider whether it is necessary to apply the more stringent standards contemplated by the Board. The foregoing approach would more appropriately address the risks to financial stability posed by an industry sector or particular companies within an industry sector without imposing a "financial system-wide" approach that may not be appropriate to all industry sectors comprising the "financial-system" (*e.g.*, insurance companies).

IV. Any Phase-In of the Sections 165 and 166 More Stringent Standards Should Allow Sufficient Time for a NBFC to Comply.

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[18] 77 Fed. Reg. at 597.

[19] 12 U.S.C. § 5323(a)(2)(H).

[20] See http://www.naic.org/documents/committees_e_capad_RBCoverview.pdf.

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As stated above, Nationwide recommends a separate rulemaking with respect to NBFCs that clearly sets forth the process by which the Board will tailor the more stringent standards to individual firms or NBFCs in a manner consistent with the statutory mandates. However, whether in a separate rulemaking or in a revised version of the Proposed Rules, Nationwide recommends that the Board develop an extended phase-in of the Proposed Rules for NBFCs. Unlike Large BHCs, the Proposed Rules will be entirely new to most NBFCs and require the development of new infrastructure and systems in order to ensure ongoing compliance. Thus, the Proposed Rules should be appropriately tailored to allow sufficient time for NBFCs to develop the infrastructure and systems required to comply.

V. Enhanced Prudential Standards and Early Remediation Requirements.

A. Enhanced Risk-Based Capital and Leverage Requirements.

In the Proposed Rules, the Board seeks comment on the appropriateness of requiring NBFCs to have the same regulatory capital requirements, capital planning requirements, and stress testing requirements as BHCs.[21] Nationwide believes that it would be inappropriate to subject all NBFCs to a capital framework designed specifically for BHCs. Moreover, we believe that any capital framework for a NBFC should be tailored to the specific capital structure, activity mix, and predominant line of business of the particular NBFC.

Under the enhanced risk-based capital and leverage components of the Proposed Rules, which are based on the minimum regulatory capital requirements for BHCs, a NBFC would be required to hold capital sufficient to satisfy the following requirements: (i) a tier 1 risk-based capital ratio of 4 percent and a total risk-based capital ratio of 8 percent, as calculated according to the general risk-based capital rules, and (ii) a tier 1 leverage ratio of 4 percent as calculated under the leverage rule.[22] On a quarterly basis, the NBFC would be required to report to the Board its risk-based capital and leverage ratios.[23]

In addition, the Proposed Rules extend the Board's final rule on capital plans to NBFCs.[24] Thus, a NBFC would be required to (i) demonstrate its ability to meet the minimum regulatory capital requirements set forth above over a nine-quarter, forward-looking planning horizon under baseline and stressed conditions; (ii) demonstrate the ability to meet a tier 1 common risk-based capital ratio of 5 percent over the same planning horizon under baseline and stressed conditions; (iii) provide a detailed description of its process for assessing capital adequacy and how it will maintain capital commensurate with its risks; and (iv) obtain prior approval from the Board before making a capital distribution in certain circumstances.[25]

[21] 77 Fed. Reg. at 603.

[22] Proposed 12 CFR § 252.13.

[23] Proposed 12 CFR § 252.14.

[24] Proposed 12 CFR § 252.13.

[25] 12 CFR 225.8.

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As stated above, the development of any enhanced regulatory capital requirements for NBFCs, to the extent necessary, should be accomplished through a separate rulemaking process whereby the capital requirements are tailored to the specific structure, activity mix, and predominant line of business of the particular NBFC. To that end, we believe that it would be inappropriate to require NBFCs that are predominantly insurance companies to have the same minimum regulatory capital requirements, stress testing, and capital planning requirements as BHCs. A one-size-fits-all approach would fail to account for the risks peculiar to the insurance business model, including catastrophe risk, mortality risk, morbidity risk, liability risk and claims reserves fluctuations, for example, while recognizing risks less pertinent or immaterial to insurers, such as loan and lease losses and deposit liabilities. Such an approach fails to account for an insurer's asset-liability mix, which matches assets to liabilities according to durations that are typically longer than those durations experienced by banks. We believe that an insurer's capital ratios under a single, bank-centric standard would potentially result in a misleading and inaccurate depiction of the insurer's true ability to absorb risk and thereby undermine the statutory goals of Dodd-Frank.

Furthermore, whether accomplished in a separate rulemaking or in a revised version of the Proposed Rules, Nationwide believes that any enhanced risk-based capital and leverage requirements should not be applicable to NBFCs until the Board releases and finalizes its consolidated risk-based capital and leverage requirements for SLHCs. NBFCs by definition are not BHCs, but it is possible that a company designated as a NBFC will also own an insured depository institution, thereby also making it an SLHC currently subject to Board supervision. Because there is significant diversity among the business models of SLHCs, and because SLHCs' operations are heavily weighted toward nondepository activities, we believe the Board should first establish its consolidated risk-based capital and leverage requirements for SLHCs before developing enhanced risk-based capital and leverage requirements for NBFCs. The Board should give specific consideration to the diverse business models of SLHCs in developing its consolidated risk-based capital and leverage requirements for each particular class of SLHCs. Then, to the extent any SLHC would be designated as a NBFC, the Board should use the yet-to-be-established SLHC consolidated capital requirements as the basis for any enhanced regulatory capital requirements, rather than attempting to fit all NBFCs into a framework designed specifically for large, complex BHCs.

In developing its consolidated risk-based capital and leverage requirements for SLHCs that are predominantly insurance companies, Nationwide has recommended that the Board should treat insurance companies as a class and deem adherence to the NAIC's risk-based capital standards, which has been adopted in all states, as functionally equivalent to the Dodd-Frank Act's insured depository institution capital standards[26] as required under Section 171.[27] We

[26] See Nationwide Comment Letter to 76 Fed. Reg. 22662 filed on May 12, 2011.

[27] Under Section 171 of the Dodd-Frank Act, the appropriate Federal banking agencies are required to establish minimum risk-based capital and leverage capital requirements on a consolidated basis for insured depository institutions, depository institution holding companies, and nonbank financial companies supervised by the Board of Governors that are not less than the generally applicable risk-based and leverage capital requirements, which shall serve as a floor for any capital requirements that the agency may require, nor quantitatively lower than the generally

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believe that so doing effectively implements the discipline, rigor and stringent standard of Section 171 while accounting for the nature and degree of risk in the insurance business model with its longer-term obligations compared to those of a typical bank. We submit that the NAIC's risk-based capital framework for insurance companies is substantially identical to the bank risk-weighting framework in terms of its stringency and its goal of requiring the insurance company to set aside sufficient capital to absorb risk; however, in administrative application, it is specifically designed for and suited to the risk profile and asset portfolio mix of an operating insurance company.

We note that the above approach has a precedential basis. Notably, the principle of equivalence is used by the Board to determine if the capital of a foreign bank is equivalent to the capital that would be required of a BHC in the United States. We think a similar approach makes sense and is an especially sound approach for domestic insurance companies. Moreover, this approach would be consistent with Section 165(b)(3), which directs the Board to adapt the required standards as appropriate in light of any predominant line of business of a NBFC.

Thus, as stated above, Nationwide believes that the Board should institute a separate rulemaking that specifically sets forth the process for tailoring the enhanced prudential standards to NBFCs, consistent with the statutory mandates. With respect to any enhanced risk-based capital and leverage requirements for NBFCs, they should not be applicable until the Board releases and finalizes its consolidated risk-based capital and leverage requirements for SLHCs. Finally, when developing consolidated risk-based and leverage capital requirements for SLHCs that are predominantly insurance companies, the Board should recognize the NAIC's risk-based capital regime as functionally equivalent to the Dodd-Frank Act's insured depository institution capital standards as required under Section 171.

B. Liquidity Requirements

1. Liquidity Risk Management Requirements Should be Specifically Tailored to NBFCs

Nationwide is concerned that the Proposed Rules do not properly account for the differences between Large BHCs and NBFCs that are predominantly insurance companies with respect to liquidity risk management requirements as these requirements are heavily geared toward banking entities.

The Proposed Rules impose the following liquidity requirements on both Large BHCs and NBFCs: (i) corporate governance requirements for a Covered Company's board of directors and senior management, and an independent review function; (ii) short- and long-term cash flow projection requirements; (iii) liquidity stress testing requirements for projected cash flows; (iv) establishment of a liquidity buffer of unencumbered, highly-liquid assets; (v) development and maintenance of a contingency funding plan, updated at least annually, to help manage liquidity

applicable risk-based and leverage capital requirements for insured depository institutions as of the date of enactment of the Dodd-Frank Act. See 12 U.S.C. § 5371(b).

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stress events; (vi) adherence to specific limits on potential sources of liquidity risk; (vii) monitoring of liquidity risks; and (viii) adequate documentation of all material aspects of the liquidity risk management process and compliance with the Proposed Rules.[28]

NBFCs that are predominantly insurance companies should be treated much differently than Large BHCs for purposes of liquidity risk management as they face an entirely different set of liquidity risks. Insurance companies are funded through upfront premium flow and, unlike banks, are not required to rely on wholesale funding and demand deposits to finance their operations. An insurance company's liabilities tend to be longer-term obligations. While insurance contracts can result in short-term payouts, claims on insurance policies often result in long-term obligations with controlled outflows that can take many years to pay out. Thus, NBFCs that are also insurance companies are unlikely to experience the same liquidity risks faced by Large BHCs that rely on short-term funding. However, the Proposed Rules make no provision for these differences.

In addition, the Proposed Rules, without appropriate tailoring, would require a NBFC that is also an insurance company to establish and maintain procedures to monitor its intraday liquidity positions.[29] While it may be important for companies that engage in significant payment, settlement, and clearing activities to monitor intraday liquidity positions, it would not be appropriate for NBFCs. Likewise, the Proposed Rules call for daily and monthly cash flow projections.[30] The frequency of these projections should be graduated as there is little value in conducting projections so frequently when companies are experiencing ample liquidity. This is particularly the case for NBFCs that are predominantly insurance companies, which rely on matching long-term cash inflows from investments with long-term liabilities.

Nationwide recommends that the Board, when developing a separate rulemaking, as we request herein, that sets forth the process for tailoring application of the Proposed Rules to NBFCs consistent with the Section 165(b)(3) and (4) statutory mandates, ensure that any liquidity risk management requirements for NBFCs that are predominantly insurance companies are based on the actual risks faced by the NBFC and not based primarily on the liquidity risks faced by Large BHCs.

2. Liquidity Risk Management Responsibilities

The Board's Proposed Rules would require a Covered Company's board of directors and risk committee to engage in a number of activities that have traditionally resided with senior management. These responsibilities include the following: (1) oversight of the liquidity risk management process; (2) review and approval of liquidity risk management strategies, policies and procedures; (3) annual establishment of, and semi-annual compliance review over, a liquidity risk tolerance based on the Covered Company's capital structure, risk profile,

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[28] Proposed 12 CFR § 252.51 et seq.

[29] Proposed 12 CFR § 252.60.

[30] Proposed 12 CFR § 252.55.

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complexity, activities, size, and other appropriate risk factors; and (4) review and approval of the contingency funding plan.[31]

The Proposed Rules also require a Covered Company's risk committee, or a subcommittee thereof, to perform the following tasks: (1) at least annually, review each existing significant business line and product line and, prior to implementation, each significant new business or product line to determine any liquidity risk and ensure compliance with liquidity risk tolerance; (2) on a quarterly basis, review cash flow projections, review and approve liquidity stress testing results, approve the size and composition of the liquidity buffer, review and approve specific limits on sources of liquidity risk, review liquidity risk management information; and (3) periodically conduct reviews of the independent validation of the liquidity stress tests (discussed below).[32]

A Covered Company is also required to establish a review function, independent of the functions that execute funding (*e.g.,* treasury group), that annually reviews and evaluates the adequacy and effectiveness of the company's liquidity risk management processes; assesses the company's liquidity risk management compliance with legal and regulatory laws; and reports noncompliance and other material liquidity risk management issues to the board of directors or the risk committee.[33]

Finally, senior management at the Covered Company is required to implement the strategies, policies, and procedures for liquidity risk management, which include: (1) overseeing the development and implementation of liquidity risk measurement reporting systems, cash flow projections, liquidity stress testing, the liquidity buffer, the contingency funding plan, specific limits on sources of liquidity risk, and monitoring procedures; and (2) regularly reporting to the risk committee information necessary to facilitate its oversight.[34]

As stated above, the Proposed Rules impose a myriad of responsibilities on the board of directors and risk committee that traditionally lie with senior management. The role of the board of directors is setting policies and overseeing the implementation of those policies. For example, the board of directors should not be required to annually establish the liquidity risk tolerance. The foregoing is more appropriately suited for management, with review and approval by the board of directors.

Nationwide recommends that the Board revise the Proposed Rules to properly reflect the role of the board of directors and senior management, and re-allocate these responsibilities among a Covered Company's board of directors, risk committee, and senior management, as appropriate.

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[31] Proposed 12 CFR § 252.52

[32] Proposed 12 CFR § 252.52.

[33] Proposed 12 CFR § 252.54.

[34] Proposed 12 CFR § 252.53.

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In addition, as explained above, the Proposed Rules call for liquidity risk to be reviewed business line by business line, and product by product. We believe that what is important is the institution's liquidity and not a product's stand-alone liquidity. Liquidity should be assessed in an asset/liability framework that considers liquidity events and potential customer and market reactions. Such a framework should address the impact of new products on an institution's liquidity. Liquidity impacts of a new product can only be assessed in the context of an institutions mix of products, sources of liquidity, and diversification of those sources of liquidity. The evaluation of stand-alone product liquidity is not useful when separate from the overall context of the institution's liquidity profile.

Finally, Nationwide seeks clarification from the Board that the independent validation function can be an internal function.

3. Liquidity Buffer.

The Proposed Rules require a NBFC to maintain a liquidity buffer of unencumbered, highly-liquid assets.[35] We believe that such a requirement is overly prescriptive for NBFCs that are predominantly insurance companies, a large majority of whose liabilities are not prone to sudden withdrawals and whose operating activities tend to generate sizeable positive net cash flows. In addition, the Proposed Rules provide that assets in the liquidity buffer should be diversified and values discounted to reflect any credit risk or market volatility in the asset.[36] The Preamble to the Proposed Rules appear to exempt securities issued or guaranteed by the U.S. government or a U.S. government agency from the diversification requirement but not from the discount requirement.[37] However, Nationwide notes that a systemic liquidity event is often accompanied by a flight to safety and quality, as evidenced most recently in the financial crises of 2008, which can increase the value of U.S. government securities. Therefore, we believe that there should be a similar exemption from the discount requirement for these U.S. government securities.

C. Single-Counterparty Exposure Limits.

The Proposed Rules impose a limit on the exposure that a Covered Company and its subsidiaries may have, on a consolidated basis, to any counterparty and its subsidiaries. The Proposed Rules establish a general limit that prohibits a Covered Company from having an aggregate net credit exposure to any unaffiliated counterparty in excess of 25% of the Covered Company's "capital stock and surplus."[38] The Proposed Rules define "capital stock and surplus" for a NBFC as the total regulatory capital of such company on a consolidated basis, as determined under applicable capital adequacy guidelines, and the balance of the allowance for

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[35] Proposed 12 CFR § 252.57.

[36] Proposed 12 CFR § 252.57.

[37] See 77 Fed. Reg. at 609.

[38] Proposed 12 CFR § 252.93.

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loan and leases losses (ALLL) of the NBFC not included in Tier 2 capital in the applicable capital adequacy guidelines.[39]

We believe that the Proposed Rules go far beyond any existing rule for any highly-regulated entity, including insurance companies, and would impose significant new operational burdens that would require costly new systems to ensure compliance with a highly-complex framework.

Moreover, any rules concerning single-counterparty exposures for NBFCs that are predominantly insurance companies should be relevant and tailored to the insurance risk profile for NBFCs that are insurance companies. As we have highlighted in prior comment letters citing well-documented studies, in light of the idiosyncratic nature of the insurance business model and its much lower degree of risk exposures arising from interconnectedness relative to banks and other financial firms, it follows that the risk stemming from exposures to a single-counterparty would be lower on a continuum for insurers than banks and other financial firms. Indeed, the Proposed Rules use a bank-centric metric of ALLL in the calculation of capital and surplus, which is not reflective of insurance company risks and the insurance business model. Insurers are not in the business of making loans and, therefore, do not carry ALLL reserves like banks do. Moreover, the inclusion of ALLL is more favorable for Large BHCs *vis-à-vis* NBFCs, which engage in lower levels of lending activities. The effect of the foregoing would be to provide a competitive advantage for BHCs, as higher ALLL would lead to a higher single-counterparty exposure limit.

Also, Nationwide believes that the single-counterparty exposure limit component of the Proposed Rules does not provide for consistent calculation definitions and processes and, therefore, does not accurately account for credit mitigants. Thus, Nationwide requests that the Board revise specific aspects of the Proposed Rules on Single-Counterparty Party Exposure Limits. The Proposed Rules limit the aggregate **net** credit exposure of a covered company to an unaffiliated counterparty, thereby recognizing certain credit risk mitigants, including netting agreements for certain types of transactions, most forms of collateral with a haircut, and guarantees and other forms of credit protection. However, to arrive at aggregate net credit exposure, it is necessary to start with aggregate **gross** credit exposure.[40] Section 252.94 of the Proposed Rules details how the gross credit exposure of a Covered Company to a credit transaction should be calculated for each type of credit transaction. In determining the value of equity securities held by a Covered Company that are issued by a counterparty, the Proposed Rules require the Covered Company to use the greater of purchase price or market value. The Board states, "the valuation rules also provide that the amount of the [Covered Company's] investment in these securities can be no less than the purchase price paid by the [Covered Company] for the securities, even if the market value of the securities declines below the purchase price."[41] We recommend that Board revise this provision to reflect an "adjusted purchase price" if the book value of the security has already been reduced through a reduction

[39] Proposed 12 CFR § 252.92.

[40] Proposed 12 CFR § 252.94.

[41] 77 Fed. Reg. at 617.

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of capital stock and surplus to reflect an impairment. Single-counterparty exposure limits are a percentage of the Covered Company's capital stock and surplus. In the event that a reduction in the book value of a security has already caused a reduction of capital stock and surplus – the denominator of the single-counterparty exposure limit – the value of the single-counterparty exposure used in the numerator should also be reduced. To the extent that an other-than-temporary impairment has been used to write down both the book value of the security and capital stock and surplus, the amount of that impairment should no longer be considered an outstanding exposure.

Nationwide recommends that the definition of "eligible collateral" be expanded to include all instruments backed by the full faith and credit of the U.S., including mortgage-backed securities, and all debt instruments backed by U.S. government sponsored enterprises, also including mortgage-backed securities. In the Proposed Rules, the definition of "eligible collateral" includes debt securities that are bank eligible investments, but appears to exclude bank eligible mortgage-backed securities that are backed by the full faith and credit of the U.S. or its government sponsored enterprises.[42] Nationwide requests that the Board recognize that such mortgage-backed securities should be eligible collateral under the Proposed Rules. Such securities are the safest, highest credit quality, and highest liquid debt securities outside of U.S. Treasury bonds. These characteristics makes these securities among the most desirable collateral and superior to many other debt securities that otherwise meet the definition of eligible collateral. To the extent these securities are backed by the full faith and credit of the United States, it makes them as good as cash for purposes of determining what constitutes eligible collateral.

With respect to timing, there should be an appropriate phase-in for the application of any single-counterparty exposure limit for NBFCs. The Proposed Rules would require NBFCs to develop infrastructure and systems that collects and aggregates counterparty exposure data that exceeds any existing requirements or systems that Large BHCs currently have. The requirements of the Proposed Rules will present significant challenges for Large BHCs, but even greater challenges for NBFCs.

Finally, the Proposed Rules introduce the concept of a "major" Covered Company, and provide that it may not have an aggregate net credit exposure to any other "major" Covered Company that exceeds 10% of its "capital stock and surplus."[43] The Proposed Rules define "major" Covered Company as a BHC with $500 billion or more in consolidated assets or <u>any</u> NBFC.[44] Nationwide believes that the Dodd-Frank Act does not support such disparate and inequitable treatment and that it would not be appropriate to deem every NBFC, regardless of size, complexity and other risk-related factors, to be a "major" Covered Company. We recommend that the Board revise the final rules to provide that the decision to deem a NBFC a "major" Covered Company will be based on a review of the NBFC's predominant line of business and

[42] Proposed 12 CFR § 252.92.

[43] Proposed 12 CFR § 252.93.

[44] Proposed 12 CFR § 252.92.

the extent to which it is highly interconnected to the financial system taking into account all of the statutory risk factors in Section 115.

D. Risk Management.

1. Risk Management and Risk Committee Responsibilities Should be Appropriately Tailored to NBFCs.

The risks faced by NBFCs that are predominantly insurance companies are distinct from the risks facing banking organizations. Insurance companies face risks that are almost wholly uncorrelated with the risks faced by banks and BHCs. Insurance companies receive premium inflow upfront, and their obligations and an insurer's claim liabilities are often long-term obligations with controlled outflows that are spread to reinsurers. Nationwide recommends that the Proposed Rules define a risk management framework for NBFCs that is tailored to the actual risks faced by different classes of NBFCs, including insurance companies.

2. Board of Directors and Risk Committee Responsibilities.

The Proposed Rules would require Covered Companies and publicly-traded BHCs with more than $10 billion in total consolidated assets to establish an enterprise-wide risk committee of the board of directors.[45] The Proposed Rules places a number of managerial responsibilities on the board of directors and risk committees, which would more appropriately be required of senior management. For instance, the risk committee would be required to review and approve an appropriate risk management framework that is commensurate with the company's capital structure, risk profile, activities, size, and other risk-related factors. Such framework would include: (i) risk limitations appropriate to each line of business of the company; (ii) policies and procedures relating to risk management governance, risk management practices, and risk control infrastructure; (iii) processes and systems for identifying and reporting risks, including emerging risks; (iv) monitoring compliance with the company's risk limit structure and policies and procedures relating to risk management governance, practices, and risk controls; (v) effective and timely implementation of corrective actions; (vi) specification of management's authority and independence to carry out risk management responsibilities; and (vii) integration of risk management and control objectives in management goals and the company's compensation structure.[46]

Nationwide recommends that the Board revise the role of the board of directors and risk committee to be more closely aligned with the traditional role of these bodies, which is to set policies and oversee compliance with those policies. In addition, the Proposed Rules should clearly recognize the full board of director's ability to allocate risk management oversight responsibilities to various other board committees (*e.g.*, finance committee, audit committee). Finally, while we agree that an independent director should chair the board committee

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[45] Proposed 12 CFR § 252.126.

[46] Proposed 12 CFR § 252.126.

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responsible for enterprise-wide risk management, we do not believe that other members of the committee need to be independent.

3. Chief Risk Officer.

The Proposed Rules also require Covered Companies to employ a Chief Risk Officer ("CRO") who, among other responsibilities and qualifications, reports directly to the risk committee and the Chief Executive Officer ("CEO").[47] Nationwide does not believe that the CRO should be mandated to report to the risk committee. The CRO should be a fully integrated member of senior management so that his expertise can inform day-to-day decision making in the normal course of business. Having the CRO report directly to a committee of the board, a reporting relationship that is otherwise unique to the CEO, could interfere with the CRO's ability to influence senior management. To whom the CRO reports should be a decision left to senior management and the board of directors, who are in the best position to ensure the appropriate stature for, and the independence of, the CRO.

In addition, the risk management component of the Proposed Rules requires the CRO to directly oversee the following responsibilities: (i) allocating delegated risk limits and monitoring compliance with such limits; (ii) implementation of and ongoing compliance with, appropriate policies and procedures relating to risk management governance, practices, and risk controls and monitoring compliance with such policies and procedures; (iii) developing appropriate processes and systems for identifying and reporting risks and risk management deficiencies, including emerging risks, on an enterprise-wide basis; (iv) managing risk exposures and risk controls within the parameters of the company's risk control framework; (v) monitoring and testing of the company's risk controls; (vi) reporting risk management deficiencies and emerging risks to the enterprise-wide risk committee; and (vii) ensuring that risk management deficiencies are effectively resolved in a timely manner.[48]

Nationwide believes that the CRO should not be required to manage all these risks "directly," but that the Proposed Rules should acknowledge the role of individual business units in risk management and the CRO's seniority within the company to oversee the decisions of the individual business units. Thus, we recommend revising the risk management component of the Proposed Rules to reflect the foregoing.

E. Stress Test Requirements.

The Board states in the Preamble that the stress testing component of the Proposed Rules were built out of its experience with stress testing large, complex BHCs through the Supervisory Capital Assessment Program ("SCAP") and the Comprehensive Capital Analysis and Review ("CCAR").[49] Nationwide believes that the Board should introduce a separate rulemaking that

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[47] Proposed 12 CFR § 252.126.

[48] Proposed 12 CFR § 252.126.

[49] 77 Fed. Reg. at 625.

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sets forth the process for tailoring the Proposed Rules, including the stress-testing requirements of Section 165(i), to NBFCs based on their predominant line of business, and not on a framework built specifically for BHCs.

The Proposed Rules provide for three types of stress tests: (i) annual supervisory stress tests of Covered Companies conducted by the Board ("Supervisory Stress Tests"); (ii) annual and additional stress tests conduct by Covered Companies;[50] and (iii) annual stress tests conducted by other financial institutions that have over $10 billion in total consolidated assets and are regulated by a primary federal financial regulator (*e.g.*, SLHCs, state member banks, and medium-sized BHCs) ((ii) and (iii), collectively "Company-run Stress Tests").[51]

The Proposed Rules require the Board to publish a minimum of three different sets of economic and financial conditions, including baseline, adverse and severely adverse scenarios for the Supervisory Stress Tests.[52] In addition, the Proposed Rules indicate that these will likely be the same scenarios that would be provided in conjunction with the Company-run Stress Tests. These scenarios consist of shocks to the economic and financial system from declines in property value or other asset prices, shifts in the shape of the yield curve, marked changes in the propensity of households or firms to enter bankruptcy, or strains on households, businesses or real property markets.[53]

Nationwide believes that any analysis and conclusions drawn by the Board from the stress test results should recognize the differences in the business model of insurance as opposed to banking – especially with regard to the longer-term nature of the liabilities in insurance companies, the differences in leverage, and the lack of reliance on short-term funding.

The Proposed Rules would also make public a summary of the Supervisory Stress Test results, including company-specific information. In addition, companies conducting Company-run Stress Tests will be required to publish on their websites, or in another forum reasonably accessible to the public, a summary of their Company-run Stress Test results within 90 days of submitting its required report to the Board.[54]

Because the stress testing scenarios as proposed are bank-centric, the public disclosure of these Stress Test results may not paint an accurate picture of a NBFC or an insurance SLHC. In addition, the requirement in the Proposed Rules to report potential losses, pre-provision net revenues, allowance for loan losses, net income, future pro forma capital positions and capital ratios will likely involve making forward-looking statements. These forward-looking statements may provide forecasts that are more detailed than those currently provided in earnings guidance for public companies and information not required to be made public by nonpublic companies

[50] Proposed 12 CFR § 252.131 et seq.

[51] Proposed 12 CFR § 252.141 et seq.

[52] Proposed 12 CFR § 252.133.

[53] See 77 Fed. Reg. at 625.

[54] Proposed 12 CFR §§ 252.135 and 252.148.

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(*e.g.*, mutual insurance companies) and expose these companies to costly and unnecessary litigation.

In terms of timing, the Proposed Rules provide that the Board will publish scenarios for the upcoming annual cycle for the Supervisory Stress Tests and the annual Company-run Stress Tests during mid-November. Covered Companies would then be required to conduct the Company-run Stress Tests and include the individual results in their Capital Plan, which would need to be submitted on January 5th of the next year. Nationwide believes that this timeframe is too tight, especially given the governance requirements around stress testing. Moreover, Nationwide respectfully requests that the Board provide a more concrete timeframe for release of the scenarios, rather than simply providing mid-November.

F. Early Remediation Requirements.

The Proposed Rules subject Covered Companies to an increasingly stringent set of remediation requirements as the financial condition of the company deteriorates. A number of the triggering events (*e.g.*, capital and leverage triggers and stress test result triggers) cannot be implemented until the Board issues its final rules on consolidated risk-based capital and leverage requirements for SLHCs. Nationwide recommends, whether as part of a separate rulemaking or through revisions to the Proposed Rules, that the Board recognize an appropriate phase-in for the early remediation requirements taking into account the fact that the Board has yet to release and finalize rules on consolidated risk-based capital and leverage for SLHCs.

Second, Nationwide believes that for NBFCs that are also insurance companies, the early remediation requirements should incorporate the NAIC's risk-based capital rules. The NAIC's risk-based capital rules, much like the prompt corrective action rules for insured depository institutions, impose increased remedial actions by an insurance company's state domestic regulator as the financial condition of the insurer deteriorates.[55] We recommend that the Board adopt this existing and time-tested framework in applying the early remediation requirements of the Proposed Rules to NBFCs that are predominantly insurance companies.

Thus, the Board should revise the early remediation components of the Proposed Rules to allow for specific tailoring of the framework to the capital structure, riskiness, complexity, financial activities, size, and other risk-related factors of the NBFC. For NBFCs that are predominantly insurance companies, the Board should adopt the NAIC's risk-based capital rules as the appropriate triggers.

Conclusion

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[55] The risk-based capital rules calculate an authorized control level of capital for the insurance company, and provide for four (4) action levels which can be triggered by comparing the insurance company's total adjusted capital to its authorized control level of capital as follows: (1) Company Action Level (total adjusted capital of 150% to 200% of authorized control level); (2) Regulatory Action Level (total adjusted capital of 100% to 150% of authorized control level); (3) Authorized Control Level (total adjusted capital of 70% to 100% of authorized control level); and (4) Mandatory Control Level (total adjusted capital of less than 70% of authorized control level). See http://www.naic.org/documents/committees_e_capad_RBCoverview.pdf.

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In sum, Nationwide believes that the Board should not extend the Proposed Rules to SLHCs with "substantial banking activities" as proposed, as it is clear from the plain language and intent of Title I of the Dodd-Frank Act that only the Council has the authority to designate companies as systemically significant and subject them to enhanced prudential supervision. In addition, the Board should exclude NBFCs from the Proposed Rules and institute a separate rulemaking that specifically sets forth the tailoring process for NBFCs, and that complies with the statutory mandates in Section 165. We also urge the Board to continue to be mindful of the business of insurance and to consider the degree to which a NBFC that is predominantly an insurance company is already regulated when determining how to tailor the Proposed Rules. Moreover, as recognized by the Board on a number of occasions, many of the Proposed Rules were designed with large, complex BHCs in mind. Therefore, any final rules on the enhanced prudential standards should provide for an appropriate phase-in for NBFCs in order to give them sufficient time to develop the systems and processes necessary to comply.

As always, we appreciate the dialogue and look forward to further opportunities to comment.

Very truly yours,

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